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Re:

### Legend

Residuary Trust =

Decedent =

Spouse =

Son =

Attorney =

Law Firm =

Accountant 1 =

Accountant 2 =

Year =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

State =

Court =

State Statute =

Dear

This letter responds to your authorized representative's letter of February 1, 2011, requesting rulings on federal gift and estate tax consequences of a judicial modification of a trust.

The facts submitted are as follows. Decedent died on Date 1 survived by Spouse. Under the terms of Decedent's will, Residuary Trust was established for the benefit of Spouse during her life. Son is the sole Trustee of Trust. Residuary Trust is governed by the laws of State.

Article 5 of Trust provides that if Spouse survives Decedent then the residuary estate is to be divided into two separate trusts, Marital Trust and Residuary Trust.

Article 5B contains provisions for the payment and distribution of Residuary Trust. Specifically, Article 5B, Paragraph 5.05, Payment of Income and Principal to Wife, provides as follows:

The Trustee shall pay to or apply for the benefit of my wife during her lifetime all of the net income of the Residuary Trust in monthly or in other convenient installments, but not less often than annually. If at any time, my wife should become insane or incompetent, and my wife should be in need of additional funds for her proper care, maintenance, and support, the Trustee, in addition to the income payments provided in Paragraph 5.05, shall in his discretion pay to or apply for the benefit of my wife any amounts from the principal of the Residuary Trust, up to the entire amount of the Residuary Trust, as the Trustee deems advisable.

Paragraph 5.05 continues (hereinafter, the Withdrawal Right paragraph),

My wife shall have the right, from time to time, to direct the Trustee to pay to her or apply for her benefit such amounts from or portions of the principal of the Residuary Trust, up to the entire amount of the Residuary Trust, as she may designate in an instrument or instruments in writing delivered to the Trustee in my wife's lifetime. The Trustee shall comply with any such written directions and shall have no responsibility whatsoever to inquire into or determine for what purpose any such appropriations are made.

Paragraph 5.06 provides, generally, that upon the death of Spouse, Trust will continue to be administered as one trust but the Trustee will divide Trust into equal shares, one share for each child of Decedent's then living and one share for any deceased child to be subdivided into subshares for the deceased child's descendants.

In the fall of Year, prior to Decedent's death, Decedent and Spouse met with Attorney to prepare their estate plan. Decedent and Spouse expressed their desire that

their estate plan be drafted to avoid the maximum amount of federal estate taxes when the property passed to their children. On Date 2, Attorney mailed a draft of the will (Draft Will) to Accountant 1 requesting a letter from him confirming that the Draft Will would allow Decedent's and Spouse's estates to avoid the maximum amount of federal estate taxes when their property passed to their children. In the Draft Will, Article 5B, Paragraph 5.05 provided as follows:

The Trustee shall pay to or apply for the benefit of my wife during her lifetime all of the net income of the Residuary Trust in monthly or in other convenient installments, but not less often than annually. If at any time, in the discretion of the Trustee, my wife should be in need of additional funds for her proper maintenance and support, then the Trustee, in addition to the income payments shall in his discretion pay to or apply for the benefit of my wife such amounts from the principal of the Residuary Trust, up to the entire amount of the Residuary Trust, as the Trustee from time to time deems advisable.

The Withdrawal Right paragraph was not a part of the Draft Will. As a result, when Accountant 1 responded to Attorney on Date 3, he confirmed that the Draft Will would allow Decedent and Spouse to avoid the maximum amount of federal estate taxes when their property passed to their children.

Subsequent to Attorney's receipt of the letter from Accountant 1, but before Decedent executed his will, Attorney added the Withdrawal Right paragraph to the Draft Will. On Date 4, Attorney met with Decedent and Spouse to review the changes to the will. After the meeting, Spouse delivered an unsigned copy of the will to Accountant 2 for his review. While Spouse waited, Accountant 2 reviewed the will and prepared a letter dated Date 4 that stated that the family trust would "[pass] through without tax." Later that day, Spouse returned with the letter from Accountant 2 and Decedent executed the will as of Date 4.

On or about Date 5, Spouse was advised by her new attorneys at Law Firm that the Withdrawal Right paragraph of Article 5B, Paragraph 5.05, as added by Attorney, would cause the assets of Residuary Trust to be included in Spouse's gross estate for estate tax purposes.

In affidavits, Spouse, Attorney, and Accountant 1 represent that it was Decedent's and Spouse's intent to minimize estate taxes when their property passed to their children. Accordingly, Residuary Trust should have been drafted to ensure that the assets in Residuary Trust would not be included in the gross estate of Spouse and Spouse would not have any property or other rights to the trust property that would cause the assets to be included in Spouse's gross estate upon Spouse's death.

In order to correct the error in Residuary Trust and to accurately reflect the intent of Decedent, on Date 6, Spouse filed a petition with Court seeking to modify Residuary Trust. On Date 7, Court issued its Judgment and Order to Reform Trust (Order). Order reformed Residuary Trust by deleting Article 5B, Paragraph 5.05 of Decedent's will and replacing it with a new Paragraph 5.05 which reads as follows:

The Trustee shall pay to or apply for the benefit of my wife during her lifetime all of the net income of the Residuary Trust in monthly or in other convenient installments, but not less often than annually. If at any time, my wife should be in need of additional funds for her proper care, maintenance, and support, the Trustee, in addition to the income payments provided in Paragraph 5.05, shall in his discretion pay to or apply for the benefit of my wife any amounts from the principal of the Residuary Trust, up to the entire amount of the Residuary Trust, as the Trustee deems advisable for such purposes.

The Order reformed Residuary Trust retroactive to Decedent's date of death.

You have requested the following rulings:

1. As a result of the judicial reformation of Residuary Trust, Spouse does not possess a general power of appointment under § 2041 over the assets of Residuary Trust and thus the assets of Residuary Trust will not be included in Spouse's gross estate for federal estate tax purposes upon her death under § 2041.

2. The judicial reformation of Residuary Trust will not be treated as the exercise or release of a general power of appointment of Spouse under § 2514 that constitutes a gift for federal gift tax purposes, and Spouse will not be treated as making a gift under § 2501.

#### Ruling 1

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2031(a) provides, generally, that the value of the gross estate of the decedent shall be determined by including to the extent provided for in §§ 2031 through 2046, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

Section 2041(a)(2) provides that the value of the gross estate includes the value of all property to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power

of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

Section 2041(b)(1) provides that for purposes of § 2041(a), the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power.

Section 20.2041-1(c) of the Estate Tax Regulations provides, in part, that a power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the estate is included within the meaning of a power of appointment exercisable in favor of the decedent's estate, his creditors, or the creditors of his estate.

State Statute provides, in part, that upon petition of a trustee or beneficiary, a court may order that the terms of the trust be modified if the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions. State Statute further provides that the court will exercise discretion to order a modification or termination in a manner that conforms as nearly as possible to the probable intention of the settler.

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

In this case, the documentation submitted by Spouse strongly indicates that Decedent and Spouse did not intend for Spouse to have any control over the assets held in Residuary Trust, and that the provision in Article 5B, Paragraph 5.05 of

Residuary Trust that permitted Spouse withdrawal rights of principal from the Residuary Trust was the result of a scrivener's error. In reforming Residuary Trust, Court found that there was clear and convincing evidence of scrivener's error and that the reformation of Residuary Trust was necessary and appropriate to achieve Decedent's tax objectives, and that the reformation was not contrary to Decedent's intentions.

Consequently, we conclude that the Court's Order on Date 6, modifying the trust instrument based on a scrivener's error is consistent with applicable State law that would be applied by the highest court of that state. Article 5B, Paragraph 5.05 of Residuary Trust, as modified pursuant to the Court's Order, does not provide Spouse with a general power of appointment under § 2041(b) over the assets of Residuary Trust. Therefore, based on the facts submitted and the representations made, we conclude that the value of the assets in Residuary Trust will not be included in Spouse's gross estate under § 2041(a)(2) upon his death.

### Ruling 2

Section 2501(a) imposes a gift tax for each calendar year on the transfer of property by gift during the year by an individual.

Section 2511 provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.

For gift tax purposes, § 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

For gift tax purposes, § 2514(c) provides that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. Section 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the person possessing the power is considered a release of the power.

Section 25.2514-1(c) of the Gift Tax Regulations provides, in part, that a power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the possessor or his estate is included within the meaning of a power of appointment exercisable in favor of the possessor, his estate, his creditors, or the creditors of his estate.

As discussed in the first ruling, Residuary Trust, as modified, does not provide Spouse with a testamentary general power of appointment. Accordingly, based on the facts submitted and the representations made, we conclude that the modification of Article 5B, Section 5.05 of Residuary Trust will not constitute the exercise or release of a general power of appointment by Spouse, within the meaning of § 2514(b). Further, we conclude that the modification of Article 5B, Paragraph 5.05 of Residuary Trust pursuant to the Court's order will not be treated as a deemed transfer of an interest in Residuary Trust by Spouse for gift tax purposes under § 2501.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

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Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures

Copy for section 6110 purposes